***United States Court of Appeals***

***for the Second Circuit***


# APPELLANT'S BRIEF

# 75-7428

# United States Court of Appeals

FOR THE SECOND CIRCUIT

DIVERSIFIED MORTGAGE INVESTORS,

*Plaintiff-Appellee,*

-against-

U.S. LIFE TITLE INSURANCE COMPANY OF NEW YORK,

*Defendant-Appellant.*

*On Appeal From the United States District Court For The Southern District Of New York*

# Appellant's Brief


SHAW & LEVINE
*Attorneys for Defendant-Appellant*
Office & P.O. Address
770 Lexington Avenue
New York, N.Y. 10021
Tel. 838-7127





Dick Bailey Printers • P.O. Box X, Staten Island, N.Y. 10302 • Tel.: (212) 447-5358

TABLE OF CONTENTS

## CASES CITED

*Page*

## Other Authorities

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

---

DIVERSIFIED MORTGAGE INVESTORS,

Plaintiff-Appellee,

-against-

U.S. LIFE TITLE INSURANCE COMPANY
OF NEW YORK,

Defendant-Appellant.

---

## APPELLANT'S BRIEF

### PRELIMINARY STATEMENT

In this declaratory judgment action by a mortgagee against its title (mortgage policy) insurer, defendant-appellant appeals from an order of the U.S. District Court, Southern District of New York (Weinfeld, J.) which granted a preliminary injunction allowing plaintiff-appellee to bond or settle certain mechanic's liens filed in Greene County, New York, and which denied appellant's omnibus cross motion to dismiss the complaint.

### ISSUE PRESENTED

Did the District Court abuse its discretion in granting the preliminary injunction in view of the following factors: not all necessary parties were before the Court; there is an action pending in Supreme Court of the State of New York, Greene County which must necessarily dispose of all the issues here; there is no justiciable controversy, there is no merit to the

complaint; the injunction fixes damages against appellant, and abrogates a substantive right under the insurance contract; potential injury to appellee is minimal; and the rights of other parties referred to by the District Court are not truly involved here?

## FACTS

On September 28, 1971, appellee transmitted to appellant a mortgage in the amount of $5,000,000.00 to be recorded and insured by the defendant (JA9)*. The letter of transmittal referred to a loan agreement, which had been executed, but did not refer to a "building loan agreement" and the loan agreement was submitted at a later time (JA68). No building loan agreement was ever forwarded to defendant for filing, as alleged in appellee's application for a preliminary injunction. The title policy issued by appellant was in the sum of $5,000,000.00, and was subject to certain conditions and limitations.

The mortgagor and original developer of the insured land development in Greene County, New York, defaulted in payment of the mortgage, and in completing the development, (JA149-150) and the appellee, as mortgagee, is seeking to complete the development.** Unfortunately, in order to do so, it needs the cooperation of the contractors who filed between $1,800,000.00 and $2,000,000.00 in mechanic's liens. Its only hope of doing so is to get them paid and still retain a valid mortgage lien on the property. (JA107)

Thus, prior to the time when the lienors sued to enforce their purported liens, appelee herein asked appellant to pay the liens. (JA 107) When suit was started in New York Supreme Court,

---

* Numbers in parenthesis refer to pages of the Joint Appendix unless otherwise indicated.

** Under what authority, we do not know, since the only interest it has disclosed to appellant or the District Court, is as the holder of a mortgage lien.

Greene County, without naming appellee herein as a defendant, was almost ready to be tried, the supplemental summonses and complaints were served, naming appellee as a defendant (JA108-109).

Appellant herein, of course, agreed to defend, at appellee's original request, but since that time appellee has consistently refused to cooperate in the defense of the action. (JA111-116).

The original loan agreement does not meet the standard tests of a "building loan agreement". On the contrary, it contained a covenant which negated any obligation on the part of appellee to supply any funds for construction purposes. (JA 160-163).

Appellant insured the first mortgage to the extent of the initial advance not to exceed $5,000,000.00. The record is obscure as to how much was advanced by appellant under the insured mortgage and as to how much had been repaid by the mortgagor. Appellant was the mortgagee in several subsequent mortgages executed by the mortgagors. These subsequent mortgages were not insured, and there is no way of knowing what monies were advanced under such mortgage, since it appears that the mortgagor was engaged in a land sale program i.e. subdivising a large tract in which individual lots were to be sold to individuals for subsequent development as recreation homes, and the development was contemplated to be structured in stages (JA5).

The record is also obscure as to when work was undertaken by those claiming to be lienors. It cannot be determined at this time whether the claimed lienors were engaged in connection with the first stage development, for which appellee had executed a covenant from the mortgagor to seek construction funds from another source, or whether the work was performed on a second stage.

When the mortgagor defaulted on the several mortgages held by appellee, the entire development came to a standstill. Lienors filed liens approximately $1,800,000.00 of which a substantial amount was cumulative; i.e., liens filed by several suppliers or sub-subcontractors of a sub-contractor. Appellant has con-

tinually asserted the priority of appellee's mortgage against the filed liens.

## THE PRIOR PROCEEDINGS

The complaint herein, set forth in full at JA148-155, alleges in substance that appellant negligently failed to file a building loan agreement, required by Section 22 of the New York Lien Law, which was the underlying agreement pursuant to which the insured mortgage was executed. No copy of the alleged "building loan agreement" was annexed to the complaint.

Thereafter, appellee brought on its application for a preliminary injunction, alleging that it faced irreparable injury in the following respects:

(a) The "project" cannot be completed until the mechanic's liens are discharged.

(b) Lot purchasers may cease making payments.

(c) Such results would have a disastrous effect on appellee's financial resources.

In addition, an affidavit of the Secretary of State of New York was submitted, *on behalf of appellee*, not the lot purchasers, to the effect that the purchasers would suffer great harm unless the project was completed. No copy of the alleged "building loan agreement" was annexed to the application for a preliminary injunction.

Appellant submitted papers opposing the application for a preliminary injunction, contesting all of appellee's allegations, and cross-moved for dismissal of the complaint on various grounds. In its rebuttal affidavit, appellee characterized the issue of whether a building loan existed as "extraneous" (Snoddy rebuttal affidavit, par. 3). (JA132) No copy of the alleged "building loan agreement" was annexed to the rebuttal affidavit.

On argument of the application for the preliminary injunction, the District Court, expressing *sua sponte* lack of

familiarity with the question of priorities under the New York Lien Law, asked for a copy of the alleged "building loan agreement", which appellee's counsel presented for the first time. The Court, in granting the injunction, did not deal with the question of whether there was any merit to appellee's contention that a building loan agreement was involved, but merely denied appellant's cross motion to dismiss.

The moving papers on our application to the District Court argued that appellee faced no irreparable injury, that to allow it to bond or settle the liens would irreparably injure appellant, and that the 1200 lot purchasers were faced with problems not related to the instant litigation. We argued there only one substantive point, that the loan agreement (JA156-184) permitted no inference of merit to appellee's position that a building loan agreement was involved. The Court found that there were serious questions of law to be resolved, but made no inquiry into the issues.

More importantly, the District Court failed to make any findings on the threshold questions of subject matter jurisdiction and whether all necessary parties were before the Court.

## SUMMARY OF ARGUMENT

We shall argue that the District Court committed reversible error in not deciding the questions of subject matter jurisdiction, lack of necessary parties and whether the Court should have declined to exercise its jurisdiction in view of a pending State Court action which must necessarily resolve the underlying question of whether a building loan agreement was in existence. We shall argue also that the District Court should have found no merit to the complaint as a matter of law. In view of all those factors, if plaintiff was entitled to a balancing of hardships at all, under the law of this Circuit the complaint should have been dismissed, and the motion for a preliminary injunction denied.

## ARGUMENT

### POINT I

### THE DISTRICT COURT MISCONSTRUED AND MISAPPLIED THE APPLICABLE LEGAL STANDARDS FOR THE GRANTING OF A PRELIMINARY INJUNCTION

A. *The Appropriate Standard for Review*

It is of course axiomatic that the District Court has a certain latitude in determining whether to grant or deny a motion for a preliminary injunction. However, it is equally true that this Court must exercise its own judgment as to the propriety of the District Court's action. See, e.g., *Omega Importing Corp. v. Petri-Kine Camera Co.*, 451 F.2d 1190 (2d Cir. 1971); *W.E. Bassett Co. v. Revlon, Inc.*, 354 F.2d 868 (2d Cir. 1966). This is particularly true, where, as here, the grant or denial of the preliminary injunction does not rest on an evidentiary hearing.

Thus, in *Dopp v. Franklin National Bank*, 461 F.2d 873, 879 (2d Cir. 1972), this Court, writing through Judge Kaufman, stated:

> "This is not a case, however, where there was an evidentiary hearing below and the credibility of witnesses played an essential part in the district judge's determinations. We are in as good a position as the district judge to read and interpret the pleadings, affidavits and depositions and thus have broader discretion on review. *See* Concord Fabrics, Inc. v. Marcus Brothers Textile Corp., 409 F. 2d 1315, 1317 (2d Cir. 1969)."

In this case, there was no evidentiary hearing. Basically, the District Court had before it the affidavits, pleadings and exhibits taken into evidence—which places this Court in as good a

position as the District Court to determine the appropriateness of the preliminary injunction.

B. *The Applicable Legal Standards for Granting a Preliminary Injunction*

Appellant respectfully submits that the District Court misconstrued applicable precedent regarding appellee's burden in seeking a preliminary injunction. In reading the District Court opinion, one gets the impression that Judge Weinfeld felt it incumbent upon himself to grant a preliminary injunction in this matter if he were merely satisfied that appellee had stated a claim upon which relief might someday be granted. This mere recitation of allegations is not an appropriate basis for granting a preliminary injunction under the decided cases and, moreover, is procedurally deficient under Rule 65(d) of the Federal Rules of Civil Procedure.

As this Court is aware, the requirements for the granting of a preliminary injunction have been stated in various ways. Under one expression of them, which appears in many of the more recent cases, the moving party must establish both a clear likelihood of its probable success on the merits and that it will be irreparably injured unless the requested form of preliminary relief is granted. *See, e.g., Dopp v. Franklin National Bank, supra; Intercontinental Container Transport Corp. v. New York Shipping Association,* 426 F. 2d 884 (2d Cir. 1970).

A second expression of the standards developed out of *Hamilton Watch Co. v. Benrus Watch Co.*, 206 F. 2d 738 (2d Cir.), affirming 114 F. Supp. 307 (D. Conn. 1953), in which the Court stated:

> "To justify a temporary injunction *it is not necessary that the plaintiff's right to a final decision, after a trial, be absolutely certain, wholly without doubt; if* the other elements are present (*i.e.*, the balance of hardships tips *decidedly* toward plaintiff), it will ordinarily be enough that the plaintiff has raised questions going to the merits

> *so serious, substantial, difficult and doubtful,* as to make them a fair ground for litigation and thus for more deliberate investigation." 206 F.2d at 740. (Footnote omitted; emphasis added.)

This language from *Hamilton* has been often cited. *See, e.g., Omega Importing Corp. v. Petri-Kine Camera Co., supra; Dino DeLaurentiis Cinematografica, S.P.A. v. D-150, Inc.,* 366 F.2d 373 (2d Cir. 1966).

Detailed examination of the numerous cases since *Hamilton* demonstrates that the differences between the two formulations of the rule are more apparent than real. Thus, whether a panel of this Court adopted the language of the *Hamilton* opinion or not, basically, it engaged in the following balancing process; If the movant had made an overwhelming display as to the likelihood of success on the merits, the balance of equities would have to tip only slightly in its favor. On the other hand, if the balance of equities tips overwhelmingly in the favor of the movant, the requirement of demonstrating a likelihood of success on the merits is somewhat diminished in importance. *See, e.g. Dopp v. Franklin National Bank, supra; Cerruti, Inc. v. McCrory Corp.* 438 F. 2d 281 (2d Cir. 1971); *Packard Instrument Co. v. ANS, Inc.*, 416 F. 2d 943, (2d Cir. 1969); *Checker Motors Corp. v. Chrysler Corp.*, 405 F. 2d 319 (2d Cir.), *cert. denied,* 394 U.S. 999 (1969); *Unicon Management Corp. v. Koppers Co.*, 366 F. 2d 199 (2d Cir. 1966).

However, mere speculation that a claim for relief is stated and that injury will occur certainly cannot support the issuance of a preliminary injunction. As this Court recently stated in *General Fireproofing Co. v. Wyman,* 444 F. 2d 391, 393 (2d Cir. 1971):

> "The difficulty with this argument, however, is that more than an abstract or nebulous plan to possibly commit a wrong sometime in the future, must be shown before the broad and potentially drastic injunctive power of the court will be exercised. Rather, '[i]njunction issues to prevent existing or *presently threatened in-*

*juries.*' Connecticut v. Massachusetts, 282 U.S. 660, 674, 51 S. Ct. 286, 291, 75 L. Ed. 602 (1931) (emphasis supplied). It is clear beyond cavil that Wyman and American lack the present capability of putting the alleged plan into effect. Accordingly, it can hardly be said to present an imminent threat . . . That some day in the vague future enough General Stock may be committed to elect Wyman or his nominee to a directorship, or to approve a merger, will not suffice. . . "

## POINT II

## THERE IS NO JUSTICIABLE CONTROVERSY PRESENT HERE TO CONFER SUBJECT MATTER JURISDICTION ON THIS COURT.

Declaratory judgment is a procedural device only, and does not create any substantive rights or duties. *Mc Carty v. Hollis*, 120 F. 2d 540 (10th Cir. 1941). As a procedural devise, it does not broaden the Court's jurisdiction nor alter the concept of justiciability. *Skelly Oil Co. v. Phillips Petroleum Co.*, 339 U.S. 667, (1950). In *Alabama Federation of Labor v. Mc Adory*, 325 U.S. 450, (1945), the Court said that the requirements for a justiciable case or controversy are no less strict in a declaratory judgment proceeding than in any other type of suit, and that it has long been considered practice not to decide abstract, hypothetical or contingent questions.

An excellent analysis of the meaning of justiciability and of its application has been offered by Chief Justice Hughes in *Aetna Life Ins. Co. of Hartford, Conn. v. Haworth*, 300 U.S. 227, (1937):

> "A 'controversy' in this sense must be one that is thus distinguished from a difference or dispute of a hypothetical or abstract character; from one that is academic or moot . . . *The controversy must be definite*

> *and concrete, touching the legal relations of parties having adverse legal interests . . .* It must be real and substantial controversy admitting of specific relief through a decree of a conclusive character, as distinguished from an opinion advising what the law would be on a hypothetical state of facts . . . " (emphasis supplied)

In this case, we do not find the usual situation under insurance contracts, where the insured seeks to compel the insurer to defend, or the insurer seeks to declare its lack of obligation to defend. Rather here, the insured seeks to prevent the insurer from defending, for its own *economic* interests. There are no adverse legal interests involved. The legal interests of the parties to this action are identical in the State court action. We submit that under such circumstances, there is no justiciable controversy presented to this Court.

Under the applicable New York law, appellee was forced in its memorandum of law to the District Court to reach the tortured position that defendant's vigorous defense against the liens is "tantamount to a refusal to defend". It is respectfully submitted that such logic is not worthy of the consideration of this Court.

In our research of the applicable cases in respect of actions between insurers and their insureds, the refusal of the insurance company to settle a case or to defend on the ground of a lapsed policy was determined as a factual question of the carrier's good faith, after liability attached to the insured. Appellee, by insisting on throwing in the towel is not presenting a justiciable controversy, but is attempting to avoid the real issue of its obligation to the lienors in the State court action, if any. The point is, the insured has no direct obligation to the lienors under New York law. Section 22 of the New York Lien Law merely provides that, if where required, no building loan contract is filed, "*the interest of each party to such contract in the real property affected thereby, is subject to the lien and claim of a person who shall thereafter file a notice of lien under this chapter.*" (emphasis supplied)

Clearly, appellee has no legal interest adverse to appellant at this stage of the proceedings. It will not have to pay a single dime, as a matter of law, to any lienor in the State court action. Only after a judgment is rendered in favor of the lienors will any controversy exist between the parties to this action. Then, the obligation will be a direct one between the insurer and the insured, not one based on the insured's obligation to a third party. As the New York Court of Appeals said in *Gordon v. Nationwide Mutual Ins. Co.*, 30 N.Y. 2d 427, 436 (1972):

> "For a breach of contract based only on a failure to make reasonable settlement of a claim within the policy limits, damages are measured by the policy limits. For a breach of implied conditions of the contract to act in its performance in good faith in refusing to settle within the policy limits, the damages may exceed the policy limits." See *Western Casualty and Surety Co. v. Herman*, 405 F. 2d 121 (8th Cir. 1968).

Thus, according to traditional concepts, the maximum obligation appellee will ever have to plaintiff is to make payments in the total amount of liens filed; if they are within the policy limits. Here, however, plaintiff has no obligation to the lienors. Thus, only after a foreclosure sale, if appellee fails to recover the insured balance of the mortgage loan, if any, can it be ascertained if appellee has suffered damage. Appellee has consistently maintained that the land development project is worth at least 25 million dollars (JA9). Thus it is clear that it can recover its insured investment after a foreclosure sale. If not, it can look to appellant for the difference, if appellee's view of the applicable law is correct.

There can be no showing of bad faith on the part of the appellant in refusing to settle, because the State action to foreclose the mechanic's liens has not even reached the stage of the service of a bill of particulars by the plaintiffs. Unable to secure any cooperation whatever from the insured, the insurer cannot possibly evaluate any of the liens filed, and their validity under

New York law, much less the question of their priority over the insured mortgage.

Appellee has not presented a controversy properly cognizable by this Court, because until it is established that the mechanic's liens have legal priority over the mortgage lien, the legal interests of appellee and appellant are identical, not adverse. In fact, it is in appellee's legal interest to adopt and cooperate in its insurer's line of defense, and defeat any claim of priority. It may not be in its economic interest to do so, however.

We respectfully submit that the concept of a justiciable controversy does not embrace adverse economic interests, but only adverse legal interests. Moreover, as we will show below, appellee failed to join in this action the necessary parties whose legal interests are adverse to it, i.e., the mechanics lienors asserting priority over the mortgage lien of appellee. Under these circumstances, this Court should clearly condemn the obvious forum shopping by appellee.

## POINT III

## THE ACTION SHOULD BE DISMISSED FOR FAILURE TO JOIN NECESSARY PARTIES.

Appellee's mortgage will be subordinate to the mechanic's liens, and appellant required to pay them, only if the insured mortgage was truly a building loan mortgage, and the provisions of Section 22 of the New York Lien Law were not complied with. The lienors must prove in the State court action what appellee alleges here that their liens have priority over the mortgage lien. Thus, the lienors are necessary parties in this action. *Maryland Casualty Co. v. Pacific Coal & Oil Co.*, 312 U.S. 270 (1941); *Central Surety & Ins. Corp. v. Caswell*, 91 F. 2d 607 (5th Cir. 1937); *Maryland Casualty Co. v. Consumers Finance Service*, 101 F. 2d 514 (2rd Cir. 1938); *Ranger Ins. Co. v. United Housing of New Mexico, Inc.*, 488 F. 2d 682 (5th Cir. 1974).

The failure to join such parties was probably a conscious one, inasmuch as a realignment of the parties would be necessary since the claimant's interests and the appellee are identical, and diversity would be destroyed, as the lienors are all New York residents, as is appellant. Vol. 6A *Moore's Federal Practice*, 2nd Edition, ¶57.19 at pp. 57-203, 204, 205; *cf. Maryland Casualty Co. v. Boyle Const. Co.*, 123 F.2d 558 (4th Cir., 1941); *State Farm Mutual Ins. Co. v. Hugee*, 115 F.2d 298 (4th Cir., 1940); *Mission Ins. Co. v. Mackey*, 340 F. Supp. 824 (WD Mo. 1971).

Clearly, assuming *arguendo*, the existence of a justiciable controversy here, the necessary parties are not before this Court. As is more fully developed in POINT IV of this brief, the likelihood of inconsistent results is great and appellant would be unprotected in such a situation. Thus the absence of necessary parties is crucial.

## POINT IV

## THE DISTRICT COURT SHOULD HAVE DECLINED TO EXERCISE ITS JURISDICTION IN FAVOR OF THE PENDING ACTION IN THE NEW YORK SUPREME COURT.

An action for declaratory judgment must settle the controversy, and it must not be used as a device to provide another arena for a race for res-judicata. *Kerotest Mfg. Co. v. C-O-Two Fire Equipment Co.* (1952) 342 U.S. 180. Thus, where a previously instituted state action would necessarily settle the issues raised in the federal declaratory action, the federal court should dismiss the declaratory action. *American Automobile Ins. Co. v. Freundt*, 103 F. 2d 613 (7th Cir., 1939); *Mutual Life Ins. Co. of New York v. Brannen*, 31 F. Supp. 123 (SD Iowa, 1940); *Maryland Casualty Co. v. Consumers Finance Service*, 101 F. 2d 514 (3rd Cir., 1938); *Weinstein v. Williams-Mc Williams Industries*, 313 F. Supp. 876 (Del., 1970); *Murray B. Marsh Co. v. Mohasco Industries, Inc.*, 326 F. Supp. 651 (CD. Cal. 1971).

Obviously, the underlying issue here is whether the mortgage between appellee and its borrower was a building loan mortgage or a mortgage contemplating future advances. In order for the lienors to succeed in establishing a priority over plaintiff's mortgage, they must prove in the State court action what appellee alleges here, that it was in fact a building loan mortgage and that Section 22 of the New York Lien Law was not complied with. And in the State court case, all of the parties are present before the Court.

Apart from the fact that all the parties are before the State Court, appellant here faces the possibility of inconsistent results in the two actions, with respect to the underlying issue of the nature of the transaction. Should it be successful here, it probably could not claim res judicata or collateral estoppel in the State court against the lienors, since they are not parties here.

On the other hand, facing direct opposition from its insured, who should be joining the insurer in opposing the lienors, the insurer could be subject to an adverse result here that it would be bound by in the State Court. Thus, a victory for defendant here would be empty, and a defeat fatal.

For the above reasons, the District Court should have dismissed this action in the proper exercise of its discretion.

## POINT V

**SINCE THE MORTGAGE INSURED BY APPELLANT WAS NOT A BUILDING LOAN MORTGAGE, AND THE AGREEMENT PURSUANT TO WHICH IT WAS EXECUTED WAS NOT A "BUILDING LOAN AGREEMENT", SECTION 22 OF THE NEW YORK LIEN LAW IS NOT APPLICABLE, AND, ACCORDINGLY, THE COMPLAINT FAILS TO STATE A CLAIM UPON WHICH RELIEF CAN BE GRANTED.**

(a)

A building loan mortgage is defined in Section 2 (14) of the New York Lien Law as follows:

> "The term 'building loan mortgage', when used in this chapter, means a mortgage made pursuant to a building loan contract and includes an agreement wherein and whereby a building loan mortgage is consolidated with existing mortgages so as to constitute one lien upon the mortgaged property."

Section 2(13) describes a building loan contract as follows:

> "The term 'building loan contract', when used in this chapter, means a contract whereby a party thereto, in this chapter termed 'lender', *in consideration of the express promise of an owner to make an improvement upon real property*, agrees to make advances to or for the account of such owner to be secured by a mortgage on such real property, whether such advances represent moneys to be loaned or represent moneys to be paid in purchasing from or in selling for such owner bonds or certificates secured by such mortgage upon such real property, providing, however, nothing herein contained shall be deemed to construe as a building loan contract

as a preliminary application for a building loan made by such owner and accepted by such lender if, pursuant to such application and acceptance, a building loan contract is thereafter entered into between the owner and the lender and filed as provided in section twenty-two of this chapter." (emphasis supplied.)

A building loan mortgage and agreement under the Lien Law of the State of New York was contrasted with a mortgage given to secure future advances in the classic case of *Weaver Hardware Co. v. Solomovitz,* by the New York Court of Appeals at 235 NY 321:

"The findings are to the effect that Solomovitz, proposing to construct a house, and not having sufficient moneys with which to do it, 'applied to the defendant *** Stalker for a loan with which to build and complete such apartment house'; that Solomovitz executed four notes and this mortgage were delivered to Stalker pursuant to an agreement 'wherein and whereby said defendant *** promised and agreed to loan to the defendant *** Solomovitz on the security of said notes and mortgage the sum of about $16,000 in money which sum was to be advanced in installments from time to time as the sum was needed in the construction or erection of a building or apartment house' (we leave out of consideration any agreement for the sale of materials, because manifestly those do not come within the statutory provisions under discussion); that thereafter three of those notes were discounted at the bank, and the proceeds placed to the credit of Stalker and by him from time to time paid out 'upon the order and request of said *** Solomovitz and as the work upon said building progressed sufficiently to make it safe and proper to make such payments.'

*Thus we have the simple transaction of a mortgage given to secure a loan for the purpose of erecting a building and to be advanced in installments from time to time as*

*might be rendered safe by the condition of the building. There is no agreement upon the part of the borrower and mortgagor to erect any building and no expression of any details such as would be appropriate to any agreement whereby one party agreed to erect and the other party agreed to loan money for the purpose of such erection.* We shall assume without deciding it that the bona fide holder for value of the notes given under such circumstances and arrangement as this would be subjected to the penalties of section 22 if this was as between the original parties a building loan agreement, and we pass to the consideration of that specific question.

All that we have here is a loan of money secured by mortgage for the purpose of putting up a building and to be advanced from time to time in installments. From time immemorial that form of loan has been common." (emphasis supplied).

This case was cited for authority in the authoritative work of Warren's Weed, *New York Real Property,* Section 1.02, which read as follows:

"It should be noted that the definition of a building loan contract as given above *required that the consideration for the agreement be the express promise of the owner to make an improvement upon the real property.* Where there is no such agreement on the part of the owner, a mortgage securing advances to be made in installments need not be accompanied by a building loan contract." (emphasis supplied).

To the same effect is *Syracuse Capital Corporation v. Pattison Construction Corp..*, 133 Misc. 894, 234 NYS 68, Aff'd 227 AD 652, 235 NYS 895.

(b)

Against this background, we must read the loan agreement of September 28, 1971 (JA156-184).

Paragraph 9 of that agreement provides (JA [illegible]-161):

"9. *WORK AND SALES PROGRESS:* All development or construction work contemplated hereunder shall be submitted to Lender for prior approval. Borrower shall proceed with all diligence to develop and construct all improvements and amenities as set forth in projections submitted to Lender in connection with the application for the Loan. *Borrower is to arrange and provide for development and construction interim financing covering all improvements and amenities in the Project. If at any time during the term of this Loan, Borrower has excess lot inventory, Lender in its discretion may refuse to disburse or commit any further funds under the Loan; however, the above refusal to disburse shall not be applicable to interim lenders to whom disbursement letters have been issued.* Borrower shall not proceed to further develop the Project in such instance unless written approval is obtained from Lender. A satisfactory sales effort shall be maintained by Borrower through the term of the Loan. The platting of the Security into the various lots, sites and parcels shall be subject to the approval of Lender, and Lender, after said approval, shall execute such dedications, releases, etc., as are necessary to permit said platting." (emphasis supplied).

Paragraph 11(c) provides (JA 162-163):

"(c) *It is contemplated that one or more institutional investors will provide the interim development and construction loans to finance the various improvements to be included under the Security of Lender.* Such a loan or series of loans will be purchased and/or extinguished and taken out with the funds allocated hereunder and as more specifically set forth in Exhibit "E" attached hereto. Lender will upon request of said interim development and construction lenders satisfactory to Lender, issue "disbursement" letters to such lenders pursuant to the terms and conditions of this Loan

ement. *Issuance of any disbursement letters shall be conditioned upon Borrower's prior submission to Lender of all plans and specifications for the proposed improvements, engineering cost estimates, copies of firm construction contracts, payment and performance bonds together with any other materials and data pertinent to the improvement and development construction to be financed by the development lender.* If the aforementioned items have been submitted and are found satisfactory, Lender will then issue the disbursement letter to the interim lender. In no event shall the amount of any disbursement Commitment or disbursement of funds hereunder be more than the actual costs of such improvements or the specific amount allocated under this Loan, whichever is the lesser figure. *At the time of disbursement of the amount necessary to extinguish the interim development loan, Lender hereunder shall be provided, as a condition precedent to such disbursement, with evidence satisfactory to it (a) that the improvements have been completed in accordance with plans and specifications approved by Lender, (b) that all contractors and sub-contractors, laborers and materialmen have been paid, (c) of the title verification and insurance to the effect that no liens or encumbrances which have not been bonded or insured against are in existence at the time of disbursement hereunder.* At no time during the term of the Loan shall the aforesaid commitments plus the outstanding loan balance and reserves exceed the face amount of the Note." (emphasis supplied).

From a reading of the two key provisions of the loan agreement, it is clear that it was appellee's intent *not* to be involved in a building loan agreement and the ramifications thereof. It is patently clear from the unambiguous wording of the agreement that such problems were to be assumed by the "interim lenders", and that appellee would not pay the "interim

lender" unless the problems inherent in a building loan were completely obviated.

One of the problems, of course, is that appellee never disclosed to appellant or the District Court, what in fact happened in actuality. Did Appelle violate its agreement and make disbursements without receiving the required protection? If so, there can be no liability on the part of appellant if subsequent acts of the appellee imperil its lien. Appellant insured a mortgage lien, not against subsequent acts of the lienholder.

On the other hand, were the conditions called for in the loan agreement fulfilled? If they were, then appellee is misleading the Court by arguing that the mechanic's liens are valid. In either event, no acts of the lender vis a vis its borrower can transfer the loan agreement into a building loan agreement so as to make appellant liable therefor.

We anticipate that appellee will argue that the loan modification of January 10, 1972, constitutes a building loan agreement and that appellant is bound thereby. In the first place, that agreement between appellee and its borrower does not change the relationship between the two parties, and it does not change in any way the obligations of the parties under the September 28, 1971, loan agreement (JA 193-194). In fact, it reinforces the original concept of the September 28, 1971, agreement that appellee was not making a building loan.

Secondly, we point out that a reading of the entire loan agreement between the borrower and Continental Mortgage Investors (CMI), reproduced at JA 195-208, establishes that it, too, is an agreement to make future advances upon completion of various stages of development, not an express promise to enter into construction. *Weaver Hardware Co. v. Solomovitz*, 235 N.Y. 321. The purpose clause in the CMI loan Agreement (JA 196) is not an express promise to contstruct by the borrower, and the "Security" for the loan is the real property itself (JA 195).

In any event, it is clear as a matter of law, that the contract of title insurance is fixed as of the date of issue, September 29,

1971, and cannot be affected by subsequent acts of the borrower and lender (JA 22). *Mayers v. Van Schaick*, 268 N.Y. 320 (1935); *Bronen v. New York Abstract Company, Inc.*, 19 AD 2d 821 (1st Dept. 1963).

Significantly, the actual mortgage insured was a conventional mortgage, on a New York Board of Title Underwriter's form, and not a building loan mortgage. (See JA 97-100, executed mortgage, and JA 104, blank form of building loan mortgage, par. 16). Under common New York real estate practice a building loan mortgage is used where there is a building loan agreement involved, not a conventional first mortgage form. Here, appellee used and submitted the conventional first mortgage form. The inference to be drawn therefrom is unmistakeable; no building loan transaction was involved.

## POINT VI

## THE DIUTRICT COURT IMPROPERLY BALANCED THE POTENTIAL HARDSHIP TO THE PARTIES

With respect first to the issue of appellant's injury, if the injunction is allowed to stand. the following is submitted:

Under the terms of the insurance policy appellant's liability arises only upon a final adjudication that the mechanics' liens have priority over the mortgage lien. No such adjudication has, of course, been made nor did the District Court find probability that such priority of the mechanics' liens would be established. The District Judge did, however, grant by way of preliminary injunction, the ultimate relief sought in appellee's fourth claim for relief, and took away a substantive right of the appellant under the terms of the contract of insurance, in that such contract prohibited the appellee from settling or bonding any liens without the permission of the appellant (JA 2). He held, however, that appellant could show no harm from such acts. It is submitted that the Judge committed clear error in adopting that position.

When appellant insured appellee's mortgage interest, it did so to the extent of the $5,000,000.00 limit written into the policy itself or less (JA 28-29). Under well settled principles of law, its exposure to the appellee was limited to any loss suffered by appellee as a result of the appellant's negligent acts of omission or commission as reduced by any repayments to appellee by the mortgagor. That sum represents the outside limit of liability to appellee, but that liability does not arise until the appellee has suffered damage. The only time that damage can arise is when the security of the mortgaged land is insufficient to satisfy the mortgage obligation. Thus, appellee has not alleged anywhere that the equity in the mortgaged land will be insufficient to satisfy the outstanding obligation under the original mortgage loan which appellant insured. Significantly, appellee has never moved to foreclose its mortgage lien, but has, instead tried to take over the entire project, at no additional investment, by itself, although it cannot do so without a foreclosure sale, at which it must bid like any other party.

Assuming arguendo that appellee is correct in stating that appellant negligently failed to file a Building Loan Agreement, there can be no damage until such time as the mechanics' liens are foreclosed and the value of appellee's mortgage lien is established. If the value of the land is sufficient to cover the remainder of the mortgage loan, then appellee has suffered no damage and appellant owes it nothing.

By bonding or settling the liens appellee will establish and fix damages if appellant is liable. There is no such thing as a bond to discharge a lien in New York which is conditioned upon the establishment of priority. If appellee bonds the lien, when the lienor establishes he is entitled to be paid by anyone, he gets paid. Thus the bonding of the lien effectively removes the issue of priority from the State Court action. Such action would clearly prejudice the appellant, inasmuch as the issue of whether the lienors provided such services and material as are within the contemplation of Section 22 of the New York Lien Law could not properly be litigated in this Court in the absence of the lienors.

The lienors have not yet provided Bills of Particular in the State action.

On the other hand, should appellee be allowed to settle the claims of the lienors, then the issue of the validity of the claims irrespective of priority, would not be available for review by either Court. The State court action would end and this Court would not have to have before it the lienors. Thus, the same factors making litigation of the issues difficult if the liens were bonded would similarly apply. If those liens were not valid *ab initio*, appellee has no right to make appellant pay them under any circumstances.

The basic proposition emerges that the appellee is being allowed to fix the damages that appellant might ultimately be liable for when there might in fact be no damage to the appellee at all. In the unlikely event that appellee can establish injury, it should not be allowed by the relief of a preliminary injunction, to fix the damage.

Appellee succeeded in blurring the issues before the District Court to the extent of implying that it somehow had the right to stand in the shoes of the owner-mortgagor and take over the construction and development of the project as it now stands. That apparently, was the basis for the District Court's finding of potential injury to Appellee.

Appellee has not disclosed to this Court any interest other than that of a money lender whose interest was secured by the mortgage. It is not clear how much appellee has invested in this project, but one thing is clear; appellant insured only one mortgage with an outside limit of $5,000,000.00 and that mortgage was repaid to the extend that the outstanding balance thereof as of July 30, 1973 was $1,700,00.00. Inasmuch as the subsequent mortgages were not insured by appellant, the only potential liability that appellant may have to appellee is that figure of $1,700,000 as reduced by payment subsequent to July 30, 1973. Unless there is insufficient equity in the land for appellee to recover that sum there is no liability on the part of appellant.

Appellee has indicated and suggested to the District Court that it is unable, in a tight cash situation, to complete the development of the project. Unless it stands in different shoes thatn it has alleged to the Court, it has no *right* to do so as a mere mortgagee, and no injury other than a loss of money which can properly accrue to the appellee. Its remedy in that respect is an action for money damages under the contract. It has the right to foreclose its own mortgage. It has the right to bid in on a foreclosure sale and it has the right to buy-out the lienors' claims at its own peril in order to protect any additional investments it made through subsequent loans not insured by the appellant, or any other title company. In short, it has no right to come to the appellant to insure one kind of transaction, and then change the deal constantly and seek to hold the appellant liable for its additional and subsequent investments.

Finally, the interest of the 1,200 lot purchasers who bought lots from Appellee's borrower falls into two categories.

1. The cloud on title caused by the filing of the mechanics' liens and

2. the necessity of completion of the development project.

With respect to the first, I point out that the mechanics' liens were filed without regard to the issue of priority of appellee's mortgage lien and in fact, the first Summonses and Complaints in the action to enforce those liens did not raise that issue.

If the lienors are entitled to be paid they have the right to foreclose their liens irrespective of the issue of priority, and those liens will always remain a cloud on title until they are discharged either by payment or completion. There is nothing appellant did or did not do which affected the title of the lot purchasers. Appellee has the option to discharge those liens as a volunteer, but not to make the defendant liable therefor.

With respect to the second issue, that of completion, there are completion bonds the Secretary of State could and should have moved against, but he has not done so.

We also pointed out that appellee has accumulated sufficient

money from its borrower to complete the project, and it should have retained that money in conformity with applicable law and its own agreement. Thus, the District Court's theory that lot purchasers were caught in a cross fire between appellant and appellee is wholly without foundation, and their rights and the enforcement of those rights lies in areas other than this action for a declaratory judgment.

We note that in view of the failure of the District Court to address itself to the threshold questions involved, and the clear lack of merit to appellee's substantive position, the balancing of hardships should have indicated that the application for a preliminary injunction be denied. Any hardship accruing to appellee was of its own making, and easily curable. To allow the injunctive relief created great potential hardship to appellant.

Reduced to most basic terms, appellee could have protected its economic interest in any way it saw fit, and then taken any action it deemed fit against appellant, should that course of action be appropriate. To give judicial sanction to such acts in advance of any determination of liability was an abuse of discression.

## CONCLUSION

**THERE BEING NO MERIT TO THE COMPLAINT AND THE PRELIMINARY INJUNCTION HAVING BEEN IMPROVIDENTLY GRANTED, THIS COURT SHOULD REVERSE THE DISTRICT COURT, DENY THE PRELIMINARY INJUNCTION AND DISMISS THE COMPLAINT.**

Respectfully submitted,

SHAW AND LEVINE
Attorneys for Defendant-Appellant

[Sgd] Jesse I. Levine
Member of the Firm

Dated: New York, N.Y.
September, 1975

JESSE I. LEVINE
Of Counsel

STATE OF NEW YORK )
: SS.
COUNTY OF RICHMOND )

ROBERT BAILEY, being duly sworn, deposes and says, that deponent is not a party to the action, is over 18 years of age and resides at 286 Richmond Avenue, Staten Island, N.Y. 10302. That on the 9 day of Sept, 1975 deponent served the within Brief upon Paul. F. Roberts, Esq. c/o Trubin, Sillcocks

attorney(s) for Appellee

in this action, at 375 Park Ave. NYC

the address(es) designated by said attorney(s) for that purpose by depositing 3 true copies of same enclosed in a postpaid properly addressed wrapper, in an official depository under the exclusive care and custody of the United States post office department within the State of New York.

Robert Bailey
ROBERT BAILEY

Sworn to before me, this
9 day of Sept., 1975.
William Bailey
WILLIAM BAILEY
Notary Public, State of New York
No. 43-0132945
Qualified in Richmond County
Commission Expires March 30, 1976